

**COMMONWEALTH OF KENTUCKY  
KENTUCKY BOARD OF TAX APPEALS  
FILE NO. K04-R-04**

**JIM BEAM BRANDS CO.**

**APPELLANT**

**VS.**

**ORDER NO. K-19415**

**COMMONWEALTH OF KENTUCKY  
FINANCE & ADMINISTRATION CABINET**

**APPELLEES**

This matter is before the Board on the Petition of Appeal filed by Jim Beam Brands Co. from a final ruling of the Finance and Administration Cabinet dated February 3, 2004. The parties have fully briefed the issues of the case.

The Board having reviewed the case including briefs, proposed findings of fact and conclusions of law and being otherwise sufficiently advised, hereby states as follow:

**FINDINGS OF FACT**

Jim Beam Brands Co. ("Jim Beam") has offices, plant facilities and warehouses in Bullitt, Nelson, Franklin and Woodford counties. It manufactures or ages distilled spirits at these facilities. The distilled spirits it produces includes, but is not limited to, bourbon, whiskeys, scotch, brandy, gin, rum and vodka.

Federal law requires that for any distilled spirit to be sold as "straight bourbon whiskey," the distilled spirit must be stored in white oak wooden barrels (the insides of which have been charred) for a two-year period. 27 C.F.R. § 5.22(b).

The distilled spirits in these barrels are stored for the purpose of aging. The distilled spirits may be aged beyond the two-year period; some distilled spirits are aged eight years or more. During this aging period, the distilled spirits are stored in bonded warehouses.

After the distilled spirits have aged for at least two years, the distilled spirits are bottled and shipped for sale as “straight bourbon whiskey.” The distilled spirits could be sold to other distillers immediately after the distilled spirits are barreled. The barrels cannot be used again to make “straight bourbon whiskey” but can be used to store other distilled spirits and are sold for that purpose.

Distilled spirits are subject to a specific method of taxation under KRS 132.130-132.180. These statutes specifically make distilled spirits subject to state and local tax. Under this method, the Department of Revenue, Finance and Administration Cabinet (“Department”) determines an estimated cost per barrel for distilled spirits, based upon an average of the distillers’ costs. This estimated cost is reduced for evaporation loss and “soakage and leakage” adjustment. This price is adjusted for the age of the barreled distilled spirit, which increases with age. To determine the value of the distilled spirits subject to tax, the Department multiplies this average barrel value by the number of barrels reported by the distiller. Jim Beam did not challenge the total assessed value of its distilled spirits.

Jim Beam filed two distilled spirits returns for the 2003 tax year. The first return identified the distilled spirits that Jim Beam claimed was subject to tax under the specific distilled spirits statutes, KRS 132.130-132.180. The second return identified distilled spirits that Jim Beam claimed was exempt from either state and/or local taxation under KRS 132.097, 132.099 and 132.200(4).

The Department issued its assessments, subjecting all of Jim Beam's distilled spirits to state and local taxation. Jim Beam protested, claiming that the foregoing exemptions applied to its distilled spirits. The Department issued its final ruling on February 3, 2004, rejecting Jim Beam's argument. Jim Beam filed its petition of appeal with this Board.

### **CONCLUSIONS OF LAW**

This Board is empowered to hear and decide appeals of final rulings of the Cabinet. KRS 131.340(1).

It is Jim Beam's position that its distilled spirits identified in its second return are exempt from tax under KRS 132.097, 132.099 and/or 132.200(4). The first two exempt property placed in a warehouse or distribution center for the purpose of subsequent shipment out of state from local and state tax, respectively. Jim Beam claims these exemptions apply to distilled spirits in warehouses aging for the first two years, to distilled spirits in holding tanks awaiting bottling, and to distilled spirits in bottles ready for the consumer market. The third exemption, KRS 132.200(4), is for raw materials actually on hand at the plant for manufacturing and products in the course of manufacture. Jim Beam claims that this exemption applies to barrels used for storage for the aging of distilled spirits and to what it identifies as "raw distillate," which is a distilled spirit.

It is the Department's long-standing interpretation and position that these exemptions do not apply to distilled spirits.

Jim Beam has the burden of proof. KRS 13B.090(7).

The issue before this Board is a matter of statutory construction. The essence of statutory construction is to ascertain and give effect to the intent of the legislature.

Statutes should be construed in such a way that they do not become meaningless or ineffectual.” Commonwealth v. Phon, 17 S.W.3d 106, 107-8 (Ky. 2000)(footnotes omitted).

Jim Beam is seeking exemptions from taxation. The rules regarding exemptions are very clear.

When the statute to be interpreted is one involving an exemption from taxation, the burden is on the taxpayer to demonstrate that it is entitled to an exemption. Exemptions from taxation are generally disfavored and all doubts are resolved against the exemption. Clearly the law has always favored equality, uniformity and impartiality in taxation. [citation omitted] Exemptions from taxation must not be presumed or implied, but rather must be clearly stated. [citation omitted].

LWD Equipment, Inc. v. Revenue Cabinet, 136 S.W.3d 472, 475 (Ky. 2004).

The legislature clearly intended to tax “distilled spirits” regardless of what they may ultimately become even if aged in charred oak barrels long enough to acquire the distinction and honor of being labeled “Kentucky Bourbon”. Specifically, under KRS 132.150, distilled spirits are specifically made subject to state and local taxation. “The spirits, in addition to the tax for state purposes, shall be taxed for county, school, and city purposes at the prevailing rates of taxation on tangible personal property in the respective counties, school districts, and cities in which the spirits are stored. . . .” Id. (emphasis added). See also KSR 132.130(1) & (2).

The General Assembly has enacted a specific method for the reporting, assessment and the taxation of distilled spirits by the Commonwealth and the local taxing jurisdictions. KRS 132.130-132.150. This method is separate and distinct from the taxation of other types of tangible personal property. It has been in existence for many years. National Distillers Products Corp. v. Board of Education, 256 S.W.2d 481, 483 (Ky. 1956)(stating that “the original counterparts of KRS 132.150 and KRS 132.160 were enacted in 1882, Acts of 1882, Chap. 1184, p. 56 . . . “); J.B. Thompson v. Commonwealth, 209 U.S. 340, 28 S. Ct. 533, 52 L.Ed. 822

(1908); City of Louisville v. Louisville Public Warehouse Co., 107 Ky. 184, 53 S.W. 291 (1899).

This method has remained relatively unchanged since that time.

The taxation of distilled spirits is unlike the taxation of other types of personal property, which takes place at the local level. Taxpayers may report their tangible personal property to either the property valuation administrator (“PVA”) or the Department. KRS 132.220(1). Taxpayers must list tangible personal property in the county where it is located. Id. The property listed is then entered into a centralized assessment system. KRS 132.486(1). Every PVA office has access to this information, Id., and the PVA assesses the property at its fair cash value. Ky. Const. § 172; KRS 132.450. Unlike distilled spirits, the General Assembly did not specifically identify that personal property as subject to state and local tax. General personal property is subject to tax unless it is specifically exempted from tax by statute, such as KRS 132.200 (exempting property from local tax).

Jim Beam’s construction of the statutes would require this Board to ignore the direct and specific language in these statutes which provide that distilled spirits are subject to both state and local taxes. Courts should avoid a construction of a statute that would result in an absurd result. Executive Branch Ethics Comm’n v. Stephens, 92 S.W.3d 69, 73 (Ky. 2002). The Department’s construction, however, results in a proper application of both statutes and gives full effect to the legislature’s intent in enacting these statutes.

Distilled spirits have been subject to state and local tax for over a century. Prior to their enactment into the Kentucky Revised Statutes in 1942, the distilled spirits laws were enacted in Ky. Stats. 4105-4113. The legislature enacted KRS 132.097 and 132.099 in 2000. 2000 Ky. Acts ch. 274, §§2 and 3. The exemption for raw materials and products in the course of manufacture was originally enacted in 1948. 1948 Ky. Acts ch. 207. The legislature is assumed

to know that distilled spirits were subject to state and local tax when it enacted these exemptions. However, it did not amend the distilled spirits tax statutes to remove the specific language that makes this property subject to state and local tax at any time during the history of the distilled spirits statutes. It has had ample opportunity to do so, but chose not to. Thus, the legislature did not intend the exemptions to apply to distilled spirits. See Fairbanks v. Large, 957 S.W.2d 307 (Ky. App. 1997).

Based on the foregoing it is this Board's opinion that the exemptions from property tax in KRS 132.097, 132.099 and 132.200(4) do not apply to distilled spirits.

Jim Beam's constitutional arguments must fail as well.

It is presumed that a statute is constitutional and the party arguing it is unconstitutional bears the burden of proof. Buford v. Commonwealth, Ky. App., 942 S.W.2d 909, 911 (1997)(citation omitted). Any constitutional violation must be "proved beyond reasonable doubt." Fidelity & Columbia Trust Co. v. Reeves, 287 Ky. 522, 154 S.W.2d 337, 343 (1941). No legislative act should be declared invalid until after all doubts have been resolved in its favor. Manning v. Sims, 308 Ky. 587, 213 S.W.2d 577, 580 (1948).

"The General Assembly has broad discretion in making tax classifications." Cooksey Brothers Disposal Co., Inc. v. Boyd County, Ky. App., 973 S.W.2d 64, 66 (1998)(subsequent history omitted)

A statute is constitutional "unless a rational basis for such law can be completely refuted. . . . the burden on the ones attacking the legislative tax arrangement is the negation of every conceivable basis which might support it." Cooksey, 973 S.W.2d at 66 citing Revenue Cabinet v. Smith, Ky., 875 S.W.2d 873, 875 (Ky. 1994). "Where there are 'plausible reasons'" for the classification or the classification is at least debatable, the inquiry under the rational basis test is

“at an end” and the classification is sustained. Federal Communications Comm’n v. Beach Communications, Inc., 508 U.S. 307, 313-4, 113 S.Ct. 2906, 124 L.Ed.2d 211 (1993). Under this rational basis standard, a classification is not invalid merely because there is an imperfect fit between means and ends. Smith, 875 S.W.2d at 875. “[I]t is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature.” Beach Communications, 508 U.S. at 315. “The assumptions underlying these rationales may be erroneous, but the very fact that they are ‘arguable’ is sufficient, on rational-basis review, to ‘immuniz[e]’ the congressional choice from constitutional challenge.” Id. at 320. Finally, “a legislative choice is not subject to courtroom fact-finding and may be based on rational speculation unsupported by evidence on empirical data.” Id. at 315.

Jim Beam’s due process rights under Ky. Const. § 2 have not been violated. Under the rational basis test, the statute must bear a rational relation to a legitimate state interest. Raising revenue is a legitimate state interest. See United States v. Carlton, 512 U.S. 26, 37, 114 S.Ct. 2018, 129 L.Ed.2d 22 (1994)(O’Connor, J., concurring); Buerer v. United States, 141 F.Supp.2d 611, 614 (W.D.N.C. 2001)(“There can be no dispute that the purpose of raising revenue is a legitimate legislative purpose.”)(citations omitted). This is particularly true for local governments, including schools. Not exempting distilled spirits from state and local taxation protects this stream of income to these jurisdictions. Historically, distilled spirits “occupie[d] a unique position in its relations to other property and to the revenue laws of this state. This is due to the fact that whisky and all alcoholic liquors were, and have been for many years, one of the chief resources for revenue for the support of the United States government. . . .” Commonwealth ex rel. Armstrong v. E. H. Taylor, Jr. Co., 101 Ky. 325, 41 S.W. 11, 13 (1897)(emphasis added). Protecting this stream of tax revenues to state and local authorities is

related to that legitimate state interest. Therefore, Jim Beam's rights under Ky. Const. § 2 have not been violated.

Jim Beam's rights under Ky. Const. § 3 have also not been violated. First, earlier versions of the distilled spirits statutes have already survived a challenge under this section. Taylor, supra. Nothing has changed in that time to alter that decision. Second, under equal protection, "a statute will be sustained if the legislature could have reasonably concluded that the challenged classification would promote a legitimate state purpose." Children's Psychiatric Hospital v. Revenue Cabinet, 989 S.W.2d 583, 587 (Ky. 1999). The "classification must be upheld against an equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." Popplewell's, 133 S.W.3d at 466-7.

In addition to the legitimate state purpose of raising revenue, the reasonable classification of distilled spirits is based upon the special relationship between distilled spirits and federal regulation. The federal government imposes a tax on all distilled spirits. 26 U.S.C. § 5001(a)(1). A "bonded premises," such as a warehouse, is a place where the government has authorized a distilled spirits operation. 26 U.S.C. § 5002(a)(3). Whoever operates bonded premises is liable for federal taxes. 26 U.S.C. § 5005(c)(1). Kentucky's specific method for taxing distilled spirits is directly related to this specific federal treatment, which is unlike other manufacturers as claimed by Jim Beam. Different regulation by the federal government is a rational basis upon which to establish a classification. See Children's Psychiatric, 989 S.W.2d at 587; Yeoman v. Commonwealth, 983 S.W.2d 459, 470 (Ky. 1998)(Legislative classifications, based upon 42 U.S.C. § 1396b(w), did not violate equal protection). Jim Beam's rights under Ky. Const. § 3 have not been violated.



Jim Beam's Section 171 argument must fail as well. That constitutional section requires that taxes "shall be uniform upon all property of the same class subject to taxation within the territorial limits of the authority levying the tax. . ." and authorizes the General Assembly "to divide property into classes...." Thus, the General Assembly may "tax different classes of property separately." Gillis v. Yount, 748 S.W.2d 357, 362 (Ky. 1988).

Section 171 requires that any classification be reasonable. Id. at 363. Any tax that is "'artificial, arbitrary [or] unreasonable'" violates Section 171. St. Ledger v. Revenue Cabinet, 912 S.W.2d 34, 38 (Ky. 1995)(subsequent history omitted). To pass this test, the classification must be "related to the constitutionally permissible classification for tax purposes." Id. "The legislature must choose some 'reasonable,' 'distinctive,' or natural' basis for its classifications." Renfro Valley Folks, Inc. v. City of Mount Vernon, 872 S.W.2d 472, 475 (Ky. App. 1993).

The reasonable classification for purposes of Section 171 is the clearly different federal treatment of distilled spirits from other types of property. The distinction is obviously tax related, given that the classification exists because of the special federal tax treatment, which is unlike other types of tangible personal property. Jim Beam's rights under section 171 have not been violated.

Finally, Section 59 has not been violated. Distilled spirits and distillers are a separate and distinct class from other types of property and taxpayers. Distilled spirits are heavily regulated by the federal government and Kentucky's taxation of them recognizes and incorporates that difference. This is acceptable under §59. See Yeoman, supra and Children's Psychiatric, supra. There is no violation of §59 in this case.

**ORDER**

The Board orders that the Cabinet's February 3, 2004 final ruling is affirmed.

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. If venue for appeal is not stated in the enabling statutes, a party may appeal to Franklin Circuit Court or the Circuit Court of the county in which the appealing party resides or operates a place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

- (a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;
- (b) A stay is permitted by the agency and granted upon request; or

(c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

**DATE OF ORDER**  
**AND MAILING: November 3, 2005**

**KENTUCKY BOARD OF TAX APPEALS**  
**FULL BOARD CONCURRING**

**NANCY MITCHELL**  
**CHAIR**